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The impact of outward-oriented economic reforms on income inequality in China

Shao-Wei Lee
University of Wollongong

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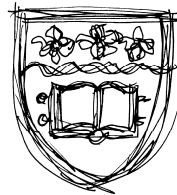
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The Impact of Outward-Oriented Economic Reforms on Income Inequality in China

A thesis submitted in partial fulfilment of the
requirements for the award of the degree

DOCTOR OF PHILOSOPHY

From



**UNIVERSITY OF WOLLONGONG
SCHOOL OF ECONOMICS, FACULTY OF COMMERCE
AUSTRALIA
2010**

by

Shao-Wei Lee

M.COM in Economics (Research), University of Wollongong

CERTIFICATION

I, Shao-Wei Lee, declare that this thesis, submitted in partial fulfillment of requirements for the award of Doctor of Philosophy, in the School of Economics of the Faculty of Commerce, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Shao-Wei Lee

November 2010

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ABSTRACT

China initiated economic reform in 1978 in the rural sector, state-owned sector, and non-state-owned sectors. The reform was extended to include foreign direct investment (FDI) and trade, particularly in the 1990s. Overall, the economic reform has been beneficial for rapid accumulating wealth and creating fast economic growth in the past few decades.

The major objective of this thesis is to study the impact of China's outward-oriented economic reform on income inequality. This study systematically tested three hypotheses: (1) outward-oriented economic reform has had an overall inequality-decreasing effect in China at the national level; (2) there has been income convergence among China's provinces; and, (3) FDI reform has had a reducing effect on wage inequality at the sectoral level. This comprehensive study and the use of highly detailed micro data contribute to the literature.

The GDP-based inter-provincial Gini coefficients on the national, eastern, central, and western regions from 1978 to 2007 were constructed. The calculated Gini coefficient shows that income inequality was widening in the 1990s, especially in the eastern region. The increased income inequality coincided with the period of all-around economic reform and accelerated when outward-oriented reforms were implemented. The Gini coefficient is then associated with reform indicators. For this national level study, first, the regression result shows that trade and SOE reforms lead to income inequality; whereas, FDI and growth improved income inequality. The eastern region dominates the inequality-increasing effect of trade and inequality-decreasing effect of FDI. Regional effects are important in explaining income inequality. The reform package introduced in 1992 plays an important role in the overall inequality-increasing effect.

For the provincial level study, income convergence for each of the study provinces from 1952 to 2007 was examined by testing for stochastic convergence and β -convergence. In the stochastic convergence analysis, the unit root test with endogenous structural break(s) suggests that breaks concentrate on the 1978 – 1984, 1992 – 1994, and 1996 – 1997 periods, which coincide with the period of the initial economic reform, all-around economic reform, and, accelerated FDI and trade reforms. This suggests that economic reform appears to be powerful in changing the path of a province's relative income toward convergence. Second, many of stochastically convergent provinces occur in the eastern region, which received government reform priority. Third, the β -convergence result reveals that many provinces, especially for eastern provinces, converge to the national average during the post reform period. Some poorer provinces receive less benefit from the reform and thus income divergence, during the reform period.

For the sectoral level study, the impact of FDI on wage inequality was examined using micro-based survey data. The results firstly suggest that wage is associated with worker's quality and condition, e.g. age, education, and occupation. Secondly, higher wage premiums usually occur in emerging sectors, including transportation and real estate sectors. Whereas, lower wage premiums usually occur in weakening sectors, such as agricultural and construction sectors. The regression results show that FDI appears to decrease wage inequality across sectors. However, the year indicator implies that FDI reform in the 1990s has had an overall increase of wage inequality across sectors. Overall, FDI appears to reduce income/wage inequality in China.

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ABBREVIATIONS

Akaike Information Criterion	(AIC)
Asian Development Bank	(ADB)
Augmented Dickey-Fuller	(ADF)
Balance of Payment	(BOP)
Central and Eastern European Countries	(CEEC)
Coefficient of Variation	(CV)
Communists Party of China	(CPC)
Computable General Equilibrium	(CGE)
Consumer Price Index	(CPI)
Dickey-Fuller	(DF)
Dependent Variable	(DV)
European Economic Community	(EEC)
European Free Trade Association	(EFTA)
European Union	(EU)
Export-Import Bank of China	(EXIM)
Factor Price Equalisation	(FPE)
Five Year Plans	(FYP)
Foreign Direct Investment	(FDI)
Foreign-invested enterprise	(FIE)
Free Trade Agreement	(FTA)
General Agreement on Tariffs and Trade	(GATT)
Generalised Entropy	(GE)
Generalised Method of Moments	(GMM)
Gross Domestic Product	(GDP)
Heckscher and Ohlin	(H-O)
H-O model and Stolper-Samuelson theorem	(HOS)
International Monetary Fund	(IMF)
Kuomintang	(KMT)
Lagrange Multiplier	(LM)
Less Developed Country	(LDC)
Ministry of Commerce	(MOFCOM)
National Bureau of Statistics	(NBS)
Non Tariff Rate Barrier	(NTB)
North American Free Trade Agreement	(NAFTA)
Other Controlling Variable	(OCV)
Ordinary Least Square	(OLS)
Organisation for Economic Co-operation and Development	(OECD)
People's Republic of China	(PRC)

Ren Min Bi	(RMB)
Im, Pesaran, and Shin	(IPS)
Levin, Lin, and Chu	(LLC)
Republic of China	(ROC)
Sectoral Indicators	(SI)
Small and medium-sized enterprise	(SME)
Special Economic Zone	(SEZ)
State-owned Enterprise	(SOE)
Township and Village Enterprise	(TVE)
United Nations Conference on Trade and Development	(UNCTAD)
United States	(US)
Urban Household Survey	(UHS)
Wage Premium	(WP)
Workers Composition Variable	(WCV)
World Development Indicators	(WDI)
World Trade Organisation	(WTO)